

# FEDERAL RESERVE BANK of NEW YORK

## OFFICE MEMORANDUM

DATE December 29, 2011

TO	File	SUBJECT	GS Conflicts of Interest Compliance Overview
FROM	Carmen M Segarra		

### RESTRICTED FR

*Bus/Con Function: Conflicts of Interest - Compliance*

*Type of Contact: Presentation (see attachment)*

*Date of Contact: 8 December 2011*

*Institution Rep: Gwen Libstag, Randy Stuzin, Tom Riggs, Una Neary, Dave Park, Tamila Ghodsi, John McGuire, Fergal O'Driscoll, Andy Chisholm*

*SSO Team Rep: Michael Silva, Susan Goldberg, Johnathon Kim, Leslie Sperber, Carmen Segarra, Ari Cohen, Mathew Blake*

*Other Rep: Grace Gonzalez (NYS-DFS), Pete Domansky (FDIC)*

*Description: GS Conflicts of Interest Compliance Overview*

### Key Meeting Exchanges

- Gwen: "... function started 100 years ago... in the context of M and A. As business evolved, it grew from a merger to a Firmwide function". "Firmwide since 2004". Gwen is a member of the Management Committee and reports to Gary. Compliance department does the Chinese wall; Gwen's group does the transactional "when what we do with one client is in conflict with another".
- Gwen: "...we follow our own principles" (slide 2) – 3<sup>rd</sup> point is particularly important to us. We work very closely with legal.
- Gwen: we get conflict checks from various areas of the firm. "We are just a piece of the larger reputational risk infrastructure." "We tend to see things upfront. We create links so that we loop in other committees. As issues evolve we use the linking to escalate. It is the business line responsibility to come to us, we make sure they do so through training.
- Gwen: We review all committee memos, we speak to the lawyer and review what they provide, when teams create projects, we make sure that we get a link to the project. We have final say.
- Gwen: Compliance and Audit backtest. We built a firmwide computer system that tracks issues raised and all trading exposures and all businesses. Dates back to 2003. Example: if we take an advisory mandate, we will continue to write research, we will continue to make the markets.
- Gwen: PR risk is subjective, the only consistency is the people involved.
- Gwen (in response to question requesting more information on how they resolved the Kinder/El Paso conflict): We are sole advisor to El Paso. We are also a longtime advisor to Kinder. Sole advisor for the contemplated spinoff. Kinder made the approach to El Paso. "No one could have anticipated that El Paso would do that." Then we had the conversation. We laid out for the Board in excruciating detail the situation. There was a debate. R Stuzin: We have board meeting minutes and email confirmation.
- Gwen: We treat ERISA pension funds different from Alternative Investments and the Merchant Bank. We discussed the recusal with the head of the MB and IB divisions.

Key Meeting Exchanges

- Gwen: "Compliance is not involved in the consultation process." R. Stuzin: "They only get involved in the implementation of the decision."
- R Stuzin (in response to question regarding the open seating arrangement layout): different lawyers from different divisions sit together. T. Riggs: There are no Chinese Walls within the legal department. R Stuzin: We don't separate Compliance people either. Gwen: It would be terrible if they were separated.
- Gwen: One of the trickiest parts for the teams is to figure out when to "phone home". When does general marketing become so specific that they need to phone home before the hard stop of client engagement letter signature process comes into play. Sometimes they have to sign confidentiality agreements.
- Gwen (slides page 11) they are [as in, they have rolled out these conflict checks] already in the Securities, Merchant Banking, and Investment Banking Divisions. The next frontier is the Investment Management Division. Last week we did the refresher training of our teams (according to Tamila). John McGuire: We have integration with legal.
- T. Riggs: (in response to more Kinder Morgan questions) "We found ourselves in that position because of the composition of the businesses of the divisions." R. Stuzin: "We have the same model as everyone else in the industry, we just do this better." Gwen (in response to M. Silva's concern that the Fed is worried about the perception that the game is rigged, that the public's confidence in the financial system is not there): "We stand by the Kinder transaction. Everyone benefitted, as determined by an independent auditor." (when asked for the name of the independent auditor) "Morgan Stanley and Evercore".
- Gwen (in response to P. Domanski question regarding if they have a mechanism to divest a holding before taking on an assignment or if they use Chinese walls instead): "Divestiture would be difficult because it is nonpublic information. Once public we put the transaction on the restricted list."
- Tamila (in response to question from S. Goldberg requesting that GS walk us through a declined transaction): "Some are based on reputational risk, for example: pornography, bankruptcy advisory, restructurings." Gwen: when the buy side comes in, but we are close to the other side... "the bulk of our issues are IBD vs. IBD issues"... "it is all fact dependent". "The process is the same as for approval, it is escalated to Gary" and then the decision is made. "Our process is not a black box."
- Gwen (in response to question from L. Sperber as to whether they have financial information on hand when making a conflicts decision): "Yes, we have it and take it into consideration. We are not a legal or compliance function. We don't hold ourselves to be that kind of a function." R Stuzin: "This is why it's called business selection. They do both."
- Gwen: indicates that if it is a true conflict, "I don't let money guide me".
- Gwen (in response to question from J. Kim regarding who determines compensation): the Finance Group determines this group's compensation.
- Gwen (in response to M. Silva's question indicating that the Fed has similar issues internally, and that the Fed has certain routines that it enters into to determine breaches of the law and what is your system for doing this?): "Internal audit does backcheck."

Key Meeting Exchanges

- Gwen (cont): “We find out occasionally from committees, from clients who complain.” The most severe ones end up in Employee Relations. Sometimes its inadvertent – the intent factor is important for GS. (M. Silva follows up with question regarding how often these cases end up in Employee Relations): 1 in 4 or 5 years. Gwen’s team (in response to question from M. Silva regarding audit): 5% of the situations.
- Gwen: it will happen that a deal takes place that is different from the deal we had originally cleared/approved. Dormant deals “wake up” and the bankers never tell us. (In response to M. Silva question regarding what happens to the banker – does the bonus get docked, for example): the bankers are supposed to refresh. Once authority is given they keep it. What we may consider dormant may not be what the client thinks is dormant. (In response to question from J. Kim regarding having time stops on a project) “we have a flag but not an automatic ticket pulled”.
- Gwen: “People view us as commercial partners. We are not perceived as cops. We are woven into the business. We want them to come to us early. The smartest bankers come to us early because of client trust”.
- Gwen: founded the group, and has been in charge of it the whole time ... “I have been in charge [of this group] longer than some people in this room have been alive”. She relies a lot on her team. She sees only 5% of what her team deals with. She loves that it is a small group. Indicates they have policies and have best practices training. Every time they make a mistake, they send around a memo containing lessons learned/best practices.
- Gwen (in response to question from S. Goldberg question regarding how do the team separation procedures work? Does it influence the set up of the shop?): in Kinder we separated the information and the team. Other times we will make a disclosure. Sometimes the clients make us agree that if a team works for one side it will not work for the other for X period of time. Each team lead meets with their sub-team on a daily basis, in a group setting so people can learn from each other.
- John confirms that they do not keep meeting notes of their internal meetings. Solutions, however are captured in the CAPS system. Fergal: we built functionality in the system to have alerts regarding the disclosures and scripts that will be delivered as a result of decisions made. David: 70-80% of the checks are ok. Of the remaining, 5% get elevated to Gwen.
- Gwen (In response to question regarding who heads each committee): Bruce Albert heads the control room and Chinese Wall. There is no separate committee firmwide for reputational risk.
- Gwen (in response to question regarding the Facebook vetting process): often clients want funds into these investments. R Stuzin: we clearly disclosed to the clients in the documents. Multiple lawyers get involved in the 80% of the cases. The 5% are dealt with by R. Stuzin and Gwen. In their estimation, IMD and IBD have most of the conflicts. Tom: there are other lawyers who cover derivatives. There is more junior level attention for the 80% of the cases – but his team is specialized.
- Gwen: Indicates they are an independent committee, they report to Gary. Decisions are documented through CAPS system and Company Query. They do have a veto power and a veto process. The group is global in nature, but legal and compliance are not represented in it.

Follow-Ups

- ☐ Follow-Up: request meeting with Chinese Wall Compliance.
- ☐ Follow-Up: procedures followed to obtain feedback from legal and compliance.
- ☐ Follow-Up: meeting to review their issues tracking system (CAPS, Company Query). Select a few issues – approved and denied transactions - and test them.
- ☐ Follow-Up: review their training.
- ☐ Follow-Up: dig deeper into Kinder Morgan – El Paso
- ☐ Follow-Up: why is the Compliance Division not involved in Conflict of Interest determinations?
- ☐ Follow-Up: seating charts. Why are there no Chinese Walls for the legal and compliance people? Client Confidentiality, Privacy, Insider Trading issues.
- ☐ Follow-Up: training on when general marketing has “gone too far” and team needs to “phone home”. Why is the deal that is completed allowed to be so different from the deal that is initially approved? Why no hard stops on dormant deals?
- ☐ Follow-Up: Dig deeper into their backchecking mechanisms.
- ☐ Follow-Up: Dig deeper into the Chinese Wall and control room; reputational risk; Ethics Officer. Also – any recusal mechanisms? Why no divestiture mechanism? What exactly is the conflict check mechanism and its escalation procedures? Why is the conflicts group not headed by an attorney? Should Finance be responsible for the conflicts team pay and bonus?